

**New Issue: Washington (State of)**

**MOODY'S ASSIGNS Aa1 RATING AND STABLE OUTLOOK TO STATE OF WASHINGTON \$298.8M VARIOUS PURPOSE G.O. BONDS, SERIES 2010A; \$401.41M MOTOR VEHICLE FUEL TAX G.O. BONDS, SERIES 2010B; AND \$64.905M G.O. BONDS, SERIES 2010T (TAXABLE)**

**APPROXIMATELY \$14.1B OUTSTANDING G.O. DEBT**

State  
WA

**Moody's Rating**

ISSUE		RATING
Various Purpose General Obligation Bonds, Series 2010A		Aa1
<b>Sale Amount</b>	\$298,800,000	
<b>Expected Sale Date</b>	07/14/09	
<b>Rating Description</b>	General Obligation	
Motor Vehicle Fuel Tax General Obligation Bonds, Series 2010B		Aa1
<b>Sale Amount</b>	\$401,410,000	
<b>Expected Sale Date</b>	07/14/09	
<b>Rating Description</b>	General Obligation	
General Obligation Bonds, Series 2010T (Taxable)		Aa1
<b>Sale Amount</b>	\$64,905,000	
<b>Expected Sale Date</b>	07/14/09	
<b>Rating Description</b>	General Obligation	

**Opinion**

NEW YORK, Jul 10, 2009 -- Moody's Investors Service has assigned a rating of Aa1 with a stable outlook to the State of Washington's \$298.8 million Various Purpose General Obligation Bonds, Series 2010A, \$401.41 million Motor Fuel Tax General Obligation Bonds, Series 2010B, and \$64.905 million General Obligation Bonds, Series 2010T (Taxable). Proceeds of the bonds will be used as follows: various purpose bonds for various statewide projects, motor fuel tax general obligation bonds for statewide transportation projects, and taxable general obligation bonds for certain taxable state projects. The bonds are scheduled to be sold on July 14.

State credit strengths are:

\*Institutionalized conservative budgetary controls.

\*Improved financial flexibility with increased rainy day fund (RDF) levels.

\*Strong demographic trends.

State credit challenges are:

\*Economic weakness and steeper-than-forecast housing downturn drive large downward revenue revisions.

\*Exposure to cyclical commercial aerospace industry.

\*Debt ratios above average and likely to increase.

\*Voter initiative activity adds element of fiscal uncertainty.

## JUNE QUARTERLY REVENUE FORECAST REVEALS FURTHER BUDGET GAPS FOR FY2009 AND 2009-2011 BIENNIUM

Washington's regularly scheduled quarterly revenue forecast last month revealed a \$184 million shortfall for fiscal year 2009, which ended June 30, and a \$502 million gap for the current biennium, 2009-2011. The state has not yet formulated a plan to close the gaps although the legislature has made provisions for an October 2009 special session to address budget shortfalls as needed. By that time, the latest revenue estimates will be available from the September quarterly forecast. The state may need to draw on available reserves earlier than planned in order to balance fiscal 2009.

## ADOPTED 2009-2011 BIENNIAL BUDGET AND FISCAL YEAR 2009 SUPPLEMENTAL BUDGET CLOSED SUBSTANTIAL \$9 BILLION COMBINED GAP

In April, Washington released its regularly scheduled quarterly forecast that confirmed the further revenue deterioration anticipated in the state's informal early guidance report in February. Revenue collections were down significantly, and the state had to address a large shortfall of \$1.3 billion in the 2007-2009 biennium and an even more substantial gap of \$7.7 billion in the upcoming 2009-2011 biennium, representing about one-fourth of the budget. As one of nine states without an income tax, Washington was spared the recent precipitous decline in capital gains-related revenue that many states experienced this past spring. However, sales taxes account for approximately 54% of Washington's general fund collections, and much of the revised forecasts reflect historically low levels of consumer confidence. The weak economy is also hurting business and occupation taxes, which represent almost one-fifth of the state's general fund revenues. In addition, projections for real estate excise taxes have also been sharply reduced due to the severity of the housing market downturn in the state.

To close the combined \$9 billion budget shortfall, the adopted supplemental fiscal 2009 and 2009-2011 biennial budgets rely on a combination of \$3.2 billion in spending cuts, \$3 billion in federal stimulus funds, \$445 million from the rainy day fund (RDF), and \$400 million in fund transfers and new resources. The state expects the following expenditure savings: 1) \$600 million from reduced Initiative 728 allocations to school districts for class size reduction; 2) \$557 million in cuts to higher education; 3) \$449 million from a change in pension actuarial assumptions and calculation methods; 4) \$338 million due to the suspension of Initiative 732 salary increases for K-12 teachers and staff; 5) \$255 million in administrative reductions across agencies; and 6) \$255 million in health care spending cuts, including reduced enrollment in the basic health plan. One-time resources such as the federal stimulus money and RDF draws represent nearly half of the Washington's budget solution. Forecast risk includes an extended recession that puts further downward pressure on the state's primary revenue source, sales taxes, which are vulnerable to the consumer confidence factors that are resulting in the current revenue underperformance. As in other states that have incorporated the receipt of federal stimulus money in their budget plans, Washington will need to formulate plans to achieve budget balance once these resources are exhausted.

## REDUCED RESERVES PROJECTED FOLLOWING RECENT DOWNWARD REVENUE REVISION

Washington's combined available reserves as of the end of the 2007-2009 biennium are now estimated at \$218 million on a GAAP basis, with \$24 million in the RDF and the remainder in unreserved, undesignated General Fund balance. The 2009 legislature's supplemental budget for the 2007-09 biennium used \$400 million of the \$442 million balance in the RDF to help fill gaps created as revenue forecasts were repeatedly revised downward as the recession took hold. The 2009 legislature also provided an unreserved, undesignated balance that was available to cover the \$184 million revenue reduction made in the June 2009 quarterly forecast update. Given what are now smaller beginning reserves and a lower revenue forecast for the current 2009-2011 biennium, the budget adopted for the 2009-11 biennium now has a significantly lower combined reserve of \$57 million projected for the end of fiscal year 2011.

In November 2007, Washington voters approved a constitutional amendment that permanently established a rainy day fund and provided for annual automatic deposits to the fund amounting to 1% of General Fund revenues, up to a maximum of 10% of General Fund revenues. The 2009-2011 enacted budget currently reflects a RDF balance of \$251 million at the end of the biennium, about 1.6% of annual General Fund Revenues, offset by a negative unreserved, undesignated General Fund balance (-\$194 million). Washington's emergency reserve (a precursor to the newly created RDF that was not constitutionally protected) peaked at \$754 million at the end of fiscal 2000, just before the 2001 recession, and was rapidly depleted by fiscal 2004 as the state addressed previous revenue shortfalls.

## JOBS DECLINE AS ECONOMY WEAKENS

Washington's recent downward revenue revisions correspond to the state's quickly decelerating economy. Automotive and housing sales have weakened more than expected, and exports have dropped sharply. The state measured average annual total non-farm employment growth of almost 1% in 2008, while jobs declined nationally at a rate of 0.4%. In the first four months of 2009, however, the state has lost jobs in most sectors with the exception of education and health services as well as government. In 2008, growth in Washington's service sector jobs offset sharp declines in construction employment, and manufacturing also began to shed jobs in the last quarter after strong gains in recent years. Washington's monthly year-over-year job losses have accelerated in 2009 and the state is now losing jobs at the same pace as the rest of the nation. The

state's unemployment rate has increased rapidly from 4.9% in April 2008 to 9.4% in May 2009, the same as the national rate. About 10,000 layoffs are anticipated at Boeing over the next 18 months, with about half of those in the state of Washington. Microsoft expects to reduce employment by approximately 2,500 jobs in Washington and 5,000 nationwide. Both firms are major employers in the Seattle region.

Washington expects that its economic recovery will parallel that of the nation. The state anticipates that it will be in recession for most of 2009, with stabilization beginning in the third quarter of the calendar year. Flat growth is expected in the first half of calendar year 2010 before a recovery begins.

#### ABOVE-AVERAGE DEBT LEVELS REFLECT GROWTH-RELATED FINANCINGS

Washington's debt ratios are about twice Moody's 50-state median level; net tax-supported debt as a percentage of personal income is 5.1%, compared with Moody's 50-state median of 2.6 % in 2008. Despite the significant increase in total debt outstanding during the previous decade, the debt-to-personal income ratio has remained fairly stable due to Washington's strong personal income growth. Even so, at \$1,908, Washington's net-tax supported debt per capita is more than twice the national median of \$889. The state's debt ratios will likely remain high given continued sizeable borrowing plans, especially for transportation purposes.

Washington has managed its debt levels through a combination of statutory and constitutional debt limits, measured by debt service as a percentage of average general state revenues for the preceding three fiscal years. This ratio is limited to 7% by statute and 9% by constitution. The state legislature recently adopted a bill to align the statutory debt limit with the constitutional limit. This creates a single transparent constraint and also provides some flexibility to support debt issuance at a time of weak revenue performance.

In recent years, Washington substantially increased its transportation infrastructure funding program, which is largely financed through the issuance of motor vehicle fuel tax general obligation bonds. As of the end of June 2009, approximately \$6.9 billion in motor vehicle general obligation bonds will be authorized but unissued. Effective July 1, 2005, the state gas tax increased by 9.5 cents (phased-in over a four-year period) in order to support the planned issuance of motor vehicle fuel tax bonds. Washington's motor vehicle fuel tax bonds are not subject to the state's debt limitation. The bonds are payable first from the state's excise taxes on motor vehicles and special fuels. The state legislature has agreed to continue to impose those excise taxes in amounts sufficient to pay debt service on the motor vehicle fuel tax general obligation bonds. On or before June 30 of each year, the Senate Finance Committee certifies to the state treasurer the amount required to pay principal of and interest on the bonds in the next fiscal year. The state treasurer shall withdraw revenues from any general state revenues received in the state treasury and from the motor vehicle fund, as applicable, and deposit in the bond fund on or before each debt service payment date amounts required to pay debt service on the bonds. While the state's gas tax receipts have been negatively affected by the recession, fiscal 2009 coverage of annual debt service on outstanding motor vehicle fuel tax general obligation bonds is expected to remain satisfactory at about 3.3 times. Almost one-third of the state's total general obligation debt is payable from motor fuel excise taxes. The state's full faith credit and taxing power are also irrevocably pledged to the payment of the bonds.

Based on an August 2008 valuation released by the State Actuary, Washington's other post-employment benefits (OPEB) liability for state employees is \$4 billion, and the annual required contribution (ARC) for fiscal year 2009 is \$331.7 million. Of that, actual contributions for fiscal year 2009 are estimated at \$86.7 million, approximately 26% of the ARC. Now that states are required to disclose actuarially compliant figures, the size of the liabilities relative to one another and their impact on states' financial statements are becoming clearer. As a result, OPEB funding status will become more visible among the many attributes Moody's assesses in the municipal credit rating process.

Washington has about \$140 million in general obligation variable rate demand bonds outstanding, representing about 1% of the state's total outstanding. The bonds are remarketed weekly and are supported by a standby bond purchase agreement with Helaba. The state has no derivative products.

#### LAST RATING ACTION AND METHODOLOGY

The last rating action was on June 2, 2009, when Moody's assigned a Aa1 rating and stable outlook to the State of Washington's Various Purpose General Obligation Refunding Bonds, Series R-2010A. The principal methodology used in rating the State of Washington's Various Purpose General Obligation Bonds, Series 2010A, Motor Fuel Tax General Obligation Bonds, Series 2010B, and General Obligation Bonds, Series 2010T (Taxable) was Moody's State Rating Methodology (October 2004), which can be found at [www.moody.com](http://www.moody.com) in the Credit Policy & Methodologies directory, in the Ratings Methodologies subdirectory. Other methodologies and factors that may have been considered in the process of rating this issuer can also be found in the Credit Policy & Methodologies directory.

#### Outlook

Washington's rating outlook is stable, reflecting our expectation that the state's finances will remain well-managed despite the recent sizeable budget shortfalls that emerged as the economy weakened. Economic

concentration in some industries that are historically volatile poses longer-term credit risk. However, the state demonstrated impressive financial flexibility through the last recession, as it accommodated resulting economic and revenue swings and has shown a willingness to curtail spending during this economic cycle.

What would change the rating - UP

- \*Sustained trend of structural budget balance, plus restoration and maintenance of strong reserve levels.

- \*Economic expansion and improved industry diversification.

- \*Reduction of debt ratios to levels closer to Moody's 50-state medians.

What could change the rating - DOWN

- \*Deeper and longer recession that restrains consumer confidence, leading to prolonged revenue weakness and employment erosion.

- \*Protracted structural budget imbalance.

- \*Increased reliance on one-time budget solutions.

- \*Cash flow narrowing, leading to strained liquidity.

- \*Failure to adopt plan to cover expenditures once federal fiscal stimulus monies are no longer available

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